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Puerto Rico Bond Default Called Over Fiscal Plan's Debt Cut Update

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Puerto Rico's entry into court protection is exacerbating tensions between Wall Street firm holding sales-tax bonds that the territory's federal overseers want impaired.

Bank of New York Mellon Corp., the trustee for $17 billion in sales-tax bonds known as Cofi notified Puerto Rico in a Thursday letter that it believes events of default have occurred, according to a copy reviewed by WSJ Pro Bankruptcy.

The alleged defaults stem from the controversial fiscal plan that Puerto Rico's oversight bo adopted as its framework for restructuring a $73 billion mountain of public debt. Last wee Governor Ricardo Rossello signed a local law to comply with the fiscal plan that allows hin under certain circumstances to break the lockbox securing the sales tax revenues and mov them into Puerto Rico's grasp.

"As a result of these limitations and restrictions on Cofina's rights and ability to meet its obligations to bondholders, the commonwealth's enactment of the fiscal plan complianc constitutes a default," BNY Mellon said in the letter. A spokeswoman declined to comment further.

Creditors holding Cofina bonds, which Puerto Rico began issuing a decade ago as an alternative way to borrow, have continued to be paid even after Puerto Rico stopped servi other debts. Even so, Bank of New York's position has become increasingly untenable. All s indicate that Cofina's special status is likely to end, leaving the bank caught between senic creditors arguing that the oversight board's stated plans to confiscate the pledged sales ta

revenues are a default, and junior creditors who want to avoid an acceleration of the senic bonds.

This week the oversight board placed Puerto Rico under a restructuring proceeding akin to bankruptcy that empowers a federal court to write down bonds by force. The fiscal plan allocates roughly $800 million a year in payments for creditors, compared with the $35 bill they are owed over the next decade. Sales taxes that had previously serviced only Cofina b would be commingled with other revenue streams and used for general purposes.

U.S. Supreme Court Chief Justice John Roberts on Friday appointed U.S. District Judge La Taylor Swain of the Manhattan, New York federal court to preside over the unprecedented proceeding.

Federal officials didn't invoke the same bankruptcy option for Cofina, the public entity tha issued the sales tax bonds, though they could do so at any time without public notice.

Judge Swain is a Brooklyn native who practiced employment law at Debevoise & Plimptor before assuming a bankruptcy judgeship in 1996. Former President Bill Clinton appointed to the federal bench in 2000.

Whitebox Advisors LLC, a holder of senior bonds, and Ambac Assurance Corp., which guarantees senior bonds, recently sued Bank of New York complaining that the trustee ha failed to protect their interests and prioritize their holdings over those of junior creditors.

Accelerating the maturity of senior bonds after a default would put their claims ahead of subordinated holders that include some of Puerto Rico's largest mutual-fund creditors.

Negotiations between Puerto Rico and major creditor groups collapsed last week when th territory indicated it wanted deeper debt concessions from Cofina creditors than from competing general obligation bondholders. The territory released offers to pay sales tax bondholders a maximum of 58 cents on the dollar, compared with 77 cents for so-called G creditors.

Puerto Rico later revised its offer to 90 cents on the dollar for the G.O.s, after which the oversight board stopped negotiations and placed the territory under bankruptcy protectic reported by WSJ Pro Bankruptcy.

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A spokesman for the federal oversight board didn't immediately respond to a request for comment.

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